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provide exceptions to subdivision (c) or (e) of this section in circumstances where he finds that application of the provisions of either subdivision would result in (i) excessive reimbursement to the facility, or (ii) severe economic hardship to the facility not caused by circumstances reasonably under the control of the facility. In determining severe economic hardship, the commissioner shall consider such factors as debt service required on capital indebtedness, prior withdrawal of assets from the facility, and the financial condition of the facility in general. In such cases where the commissioner makes a finding of severe economic hardship, the capital cost component of the rate shall not exceed the debt service on capital indebtedness.

(2) The commissioner may revise the capital cost component of the reimbursement rate applicable to any facility which he determines is based upon previous error, deceit or any other misrepresentation or misstatement by the facility.

(3) The capital cost component shall not be affected by any sale, lease or transfer occurring after March 10, 1975.

(g) In lieu of determining initial allowed facility cost pursuant to subdivision (a) of this section, the commissioner may estimate the original fair and reasonable cost of the facility with due regard for the fair and reasonable cost of facilities of comparable age, size, location and condition, and impute an initial allowed facility cost to:

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(1) every facility for which records on the historical cost or book value of land, building or nonmovable equipment are not available or not verifiable to the satisfaction of the commissioner;

(2) every leased facility which, as of the effective date of this section, is not eligible for reimbursement pursuant to subdivision (c) of this section;

(3) every facility which, after the effective date of this section, ceases to be eligible for reimbursement pursuant to subdivision (c) of this section and becomes eligible for reimbursement pursuant to subdivision (e) of this section; or

(4) every facility whose construction was completed prior to the calendar year in which this section becomes effective and whose initial facility year occurs in or after the calendar year in which this section becomes effective.

(h) In the event that a facility fails to submit information necessary for the implementation of this section, after notification pursuant to subdivision (f) of section 86-2.2 of this Subpart, the capital cost component of the rate shall consist of interest, if reported, and amortization not in excess of the lesser of the amortization payment required under capital indebtedness, or 2 1/2 percent of initial allowed facility cost.

(i)(1) The limitation provision of paragraph (e)(5) of this section may be waived for certain qualifying facilities. In order to be considered a qualifying transaction, all of the following

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(i) A sale or transfer between nonrelated parties must take place.

(ii) The purchaser must assume the seller's remaining mortgage repayment schedule at the associated fixed rate of interest.

(iii) The difference between the unpaid principal balance of the seller's mortgage (first mortgage) and the Medicaid-allowable transfer price must be generated either from second mortgage proceeds or contributed equity capital or both.

(iv) The annual amount of allowable interest expense incurred as described in this section, under the terms of the first and second mortgage, plus the annual principal debt amortization must be less than that which would otherwise be reimbursed pursuant to this section, if no assumption of the existing first mortgage were made. (This comparison is hereinafter referred to as the comparative analysis test.) For purposes of this subdivision, the loan-financed portion of the Medicaid-allowable transfer price shall be held constant and the comparative analysis test shall be applied to each year of the effective term of the first and second mortgages. In instances where more than one facility is involved in the transaction, the facilities may be combined for purposes of the comparative analysis test.

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(2) Qualifying facilities shall be reimbursed principal debt amortization, interest and return of equity in the following manner:

(i) Principal debt amortization. In each year, during the effective term of the mortgage, the capital cost component of the rate shall include a payment factor sufficient to reimburse the principal debt amortization component of the allowable portion of the mortgage.

(ii) Interest. The capital cost component shall include a payment factor sufficient to reimburse interest associated with the allowable portion of the mortgage as defined by paragraph (e)(2) of this section.

(iii) Return of equity. The equity portion of the Medicaid-allowable transfer price shall be reimbursed in equal annual amounts beginning in the first year following the expiration of the term of the mortgages over the remaining useful facility life.

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(4) The present value of the minimum lease payments (payments to be made during the lease term including bargain purchase option, guaranteed residual value and penalties for failure to renew) equals at least 90 percent of the fair market value of the leased property. This provision is not applicable if the lease begins in the last 25 percent of the useful life of the equipment. Present value is computed using the lessee's incremental borrowing rate, unless the interest rate implicit in the lease is known and is less than the lessee's incremental borrowing rate, in which case the interest rate implicit in the lease is used.

(c) If a lease is established as a virtual purchase under subdivision (b) of this section, the rental charge is includable in capital-related costs as the lesser of the annual rent or the annual costs of ownership which shall be limited to depreciation and interest. When the cost of ownership becomes less than the annual rent, the rental charge shall be includable in capital-related costs. The aggregate rental or lease costs included in capital-related costs may not exceed the costs of ownership that would have been included in capital-related costs over the useful life of the asset had the provider received legal title to the asset.

(d) If a facility enters into a sale and leaseback agreement involving equipment on or after October 23, 1992, the amounts to be included in capital-related costs are the lesser of the annual rent or the annual costs of ownership. When the cost of ownership becomes less than the annual rent, the rental charge shall be includable in capital-related costs. The aggregate rental or lease costs included in capital-related costs may not exceed the costs of ownership which shall be limited to depreciation and interest that would have been included in capital-related costs over the useful life of the asset had the provider retained legal title to the asset.

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86-2.22 Movable equipment. (a) Necessary and reasonable expenses related to movable equipment (depreciation computed on a straight-line method or accelerated under a double declining balance [on] or sum-of-the-years-digits method, interest on indebtedness, lease, etc.) are considered allowable costs for residential health care facilities subject to such ceilings as may be established and promulgated by the Commissioner of Health.

(b) An arms length lease purchase agreement with a nonrelated lessor involving equipment entered into on or after October 23, 1992 which meets any one of the four following conditions, establishes the lease as a virtual purchase.

(1) The lease transfers title of the equipment to the lessee during the lease term.

(2) The lease contains a bargain purchase option.

(3) The lease term is at least 75 percent of the useful life of the equipment. This provision is not applicable if the lease begins in the last 25 percent of the useful life of the equipment.

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86.2.24 Educational activities. The costs of educational activities, less tuition and supporting grants, shall be included in the calculation of the basic rate, provided such activities are directly related to patient care services.

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86-2.25 Compensation of operators and relatives of operators.

(a) Reasonable compensation for operators or relatives of operators for services actually performed and required to be performed shall be considered as an allowable cost. The amount to be allowed shall be equal to the amount normally required to be paid for the same service provided by a nonrelated employee, as determined by the State Commissioner of Health. Compensation shall not be included in the rate computation for any services which the operator or relative of the operator is not authorized to perform under New York State law or regulation.

(b) Any amount reported as compensation for services rendered by an operator or relative of an operator shall not be allowed in excess of the maximum allowance for full-time services in carrying out his primary function.

(c) For purposes of subdivision (a) of this section, in determining a reasonable level of compensation for operators or relatives of operators the commissioner may consider the quality of care provided to patients by the facility during the year in question.

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86-2.26 COST OF RELATED ORGANIZATIONS. (a) A RELATED ORGANIZATION shall be defined as any entity which the residential health care facility is in control of or is controlled by, either directly or indirectly, or an organization or institution whose actions or policies the facility has the power, directly or indirectly, to significantly influence or direct, or a special purpose organization, or where an association or material interest exists in an entity which supplies goods and/or services to the residential health care facility, or any entity which is controlled directly or indirectly by the immediate family of the operator. Immediate family shall include each parent, child, spouse, brother, sister, first cousin, aunt and uncle, whether such relationship arises by reason of birth, marriage or adoption.

(b) The costs of goods and/or services furnished to a residential health care facility by a related organization are includable in the computation of the basic rate at the lower of the cost to the related organization, or the market price of comparable goods and/or services available in the residential health care facility's region within the course of normal business operations.

(c) If the residential health care facility has incurred any costs in connection with a related organization, the final payment rate shall include the costs of such goods and/or services.

(d) A special purpose organization shall be defined as an organization which is established to conduct certain of the provider's patient-care-related or non-patient-care-related activities. The special purpose organization shall be considered to be related if:

(1) the facility controls the special purpose organization through contracts or other legal documents that allow direct authority over the

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(2) the facility is, for all practical purposes, the sole beneficiary of the special organization's activities. The facility shall be considered the special purpose organization's sole beneficiary if one or more of the three following circumstances exist:

(i) a special purpose organization has solicited funds in the name of and with the expressed or implied approval of the facility, and substantially all the funds solicited by the organization were intended by the contributor or were otherwise required to be transferred to the facility or used at its discretion or direction;

(ii) the facility has transferred some of its resources to a special purpose organization, substantially all of whose resources are held for the benefit of the facility; or

(iii) the facility has assigned certain of its functions (such as the operation of a dormitory) to a special purpose organization that is operating primarily for the benefit of the facility.

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